NAPF

Securing the future of pensions

Pension **Possibilities**

Making the right choices for the long term

"Much of this change reflects our recommendations to Government five years ago and much of it has been delivered by NAPF members"

The NAPF is the voice of workplace pensions in the UK. We speak for over **1,300 pension schemes** that provide pensions for over **17 million** people and have more than **£900 billion** of assets. We also have **400 members** from businesses supporting the pensions sector.

We aim to help everyone get more out of their retirement savings. To do this we spread best practice among our members, challenge regulation where it adds more cost than benefit and promote policies that add value for savers.

Introduction

Five years ago, when we last set out our vision for pensions, we started on a downbeat note: "Our pensions system, which was once the envy of the world, has been transformed to one in which 12 million people are either not saving or are not saving enough and DB pensions are in decline[1]". There are grounds for much greater optimism now:

- automatic enrolment has reversed years of decline in pension participation;
- reforms to the state pension give people much greater clarity on the deal with government;
- large schemes, operating in their members' interests, have increased value and reduced costs; and
- changes announced in the Budget 2014, while hugely challenging to implement, offer the opportunity of fitting retirement income much better to the way people actually retire.

Much of this change reflects our recommendations to Government five years ago and much of it has been delivered by NAPF members. *Pension Possibilities* shows how we can build on the opportunity we now have. It shows how we can move the UK's pension system back to a position where the world looks to us as a model and, even more importantly, to one that millions of people can rely on to deliver a comfortable retirement. Reaching that goal depends on action both by Government and the industry; it also depends on resisting the temptation to make change for change's sake. *Pension Possibilities* describes, therefore, both what needs to be done and what needs to be avoided by the next Government.

[1] NAPF Fit for the future: NAPF's vision for pensions, 2010

Six choices the next Government should make:

1. People working for small employers need the same easy access to pension saving that those working for large employers now have; we are calling on the Government to commit to **the completion of the rollout of automatic enrolment** on the current timetable.

2. Savers need their long-term interests to be at the heart of pensions policy; we are calling on the Government to create **an Independent Retirement Savings Commission**, accountable to the Secretary of State for Work and Pensions, with a clear remit to define, measure and promote good retirement outcomes. No new legislation should be proposed or enacted until this Commission is in operation.

3. Employers sponsoring defined benefit pensions need to be able to meet their promises to scheme members without facing an undue impact on their ability to invest elsewhere in the economy; we are calling on the Government to:

a. Amend the strategic objectives of the Debt Management Office so that, in advising on managing Government debt, it can also to take into account the impact of **insufficient supply of inflation-linked assets**.

b. undertake a package of measures to **unlock large-scale investment in national infrastructure** headed by a Minister with specific responsibility for infrastructure.

4. Savers pay for regulation through management charges and need costs to be kept proportionate; the Independent Retirement Savings Commission will be an important check on disproportionate cost domestically. In addition, we are calling on the Government **to oppose** any further attempts by the European Commission to drive up funding requirements through **the creation of a 'holistic balance sheet'**

5. Savers deserve a system which ensures their money is professionally managed by people with savers interests at the forefront of their thinking; we are calling on the Government to introduce a fundamental shift in the way pensions are regulated, switching from regulating, prescribing and guiding the activities of the trustees who run pension schemes to regulating the trustees themselves through **establishing criteria for the fitness, competence and expertise of trustees** and ensuring that schemes are run by trustee boards which meet those standards

6. Savers need to be equipped to make retirement decisions well in advance of retirement and to make those decisions fully informed of the benefits and risks and of the options available to them. We are calling on the Government to:

a. task the Independent Retirement Savings Commission with **reviewing retirement outcomes**, including the advice, products and solutions available to those retiring. The Commission should make recommendations to the Government and Financial Conduct Authority on improvements to the solutions available and managing any risks to individuals.

b. give the Money Advice Service a clear objective to **improve consumer understanding of retirement options**, and ensure the necessary information and education is delivered in close partnership with experts across the sector.

"Savers need their long-term interests to be at the heart of pensions policy"

Section 1: The Pension Landscape

Enough savers? Enough saving?

For the first time in a generation, the number of people saving in a workplace pension scheme is rising. That prize is the result of a hard-earned consensus built and maintained over the last ten years; a consensus that it is possible and desirable to nudge people into pension saving through automatic enrolment. That consensus has been turned into success over the past two years as more than 4.5 million people have been enrolled into a pension, with fewer than ten per cent exercising their right to opt out. And, like all successful initiatives in workplace pensions it has been delivered through partnership between Government, employers and pension schemes. The NAPF has consistently supported automatic enrolment and our members provide pensions to the majority of automatically-enrolled savers.

Automatic enrolment is not the only way in which the world of pensions has fundamentally changed over the past five years. Echoing the NAPF's campaign for a foundation pension[2] the Government has radically simplified the state pension system, replacing from April 2016 the impenetrable combination of basic and additional State Pension with a single-tier pension worth around £7,500 a year. A simple State Pension, which people can understand and build into their mental accounting for retirement, is a crucial step in helping people understand what they need to do to supplement their income.

[2] NAPF Fit for the future: NAPF's vision for pensions, 2010 pp8-13

PQM and PQM READY schemes

Communication

Schemes provide clear and engaging communications throughout a saver's membership. Communications are assessed against standards of clarity and brevity.

Governance

Schemes are well-governed with independent oversight by people with full decision-making power over the scheme's administration and investment management.

Investment

Schemes have an investment strategy with objectives designed for its specific membership. Performance against objectives is reviewed at least annually and the strategy is reviewed at least every three years.

"Right now pension schemes are getting ready to implement the biggest set of changes to pensions in a century"

Just seven months ago, the 2014 Budget provided perhaps the biggest change of all, removing the effective requirement on the majority of savers to make a single, irrevocable decision to convert their pension pot into a retirement income by buying an annuity. A change as profound as this will require several years to work through in full. While much of the focus so far has been on the guidance needed to help savers through their new range of options, the bigger changes will occur more slowly as schemes adjust their investment approaches, as savers rethink their options at retirement and demand high value, flexible products to help them manage their retirement.

No surprise then that our members have been hugely busy over the past few years, putting legislation into practice and helping their members benefit. Right now pension schemes are getting ready to implement the biggest set of changes to pensions in a century – the 2014 Budget reforms – two years into an automatic enrolment programme which was itself the biggest change for decades. More than two million people are now in schemes covered by the NAPF's Pension Quality Mark (PQM), benefitting from strong governance, clear communication and low charges. More generally average charges across our DC membership have fallen from 0.52% AMC (for trust-based schemes) and 0.58% AMC (for contract-based schemes) to 0.43% and 0.48% respectively over the past five years[3]. Much of this has been driven by the emergence of new master trust pension schemes, operating at large scale. As we highlighted in 2009, large workplace pensions such as these can, and do, bring lower costs, access to high quality investment options and strong administration and governance[4].

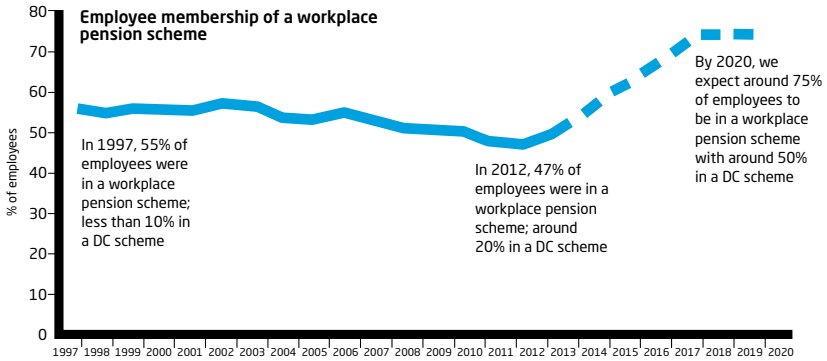
workplace pensions will become the norm...

In one, very important, sense the next few years in pensions look pre-determined. Automatic enrolment has been hugely successful so far and, driven in part by the social proofing which that initial success provides, we believe it will continue to succeed throughout the remainder of its roll-out phase. Opt-out rates may not be as spectacularly low and employer non-compliance may emerge as an issue but we expect automatic enrolment to be the major contributor to a growth in the number of members of workplace pensions to around 75% of the employee workforce over the next five years.

It is crucial that the next Government continues to maintain the consensus which has underpinned automatic enrolment so far. The millions of people working for small employers who stand to be automatically enrolled after the election deserve the same access to pension saving as those who have already been enrolled.

Recommendation 1:

The Government should commit to the completion of the rollout of automatic enrolment on the current timetable.



Saving for retirement through a workplace pension will become established as the norm for full-time employees. While automatic enrolment targets this specific group very thoroughly, however, it targets part-time employees less comprehensively and the self-employed not at all. We expect these parts of the workforce, which have been growing quickly in recent years, to continue to have relatively low levels of participation.

> "It is crucial that the next Government continues to maintain the consensus which has underpinned automatic enrolment so far"

[3] NAPF Annual Surveys [4] NAPF Fit for the future: NAPF's vision for pensions p17

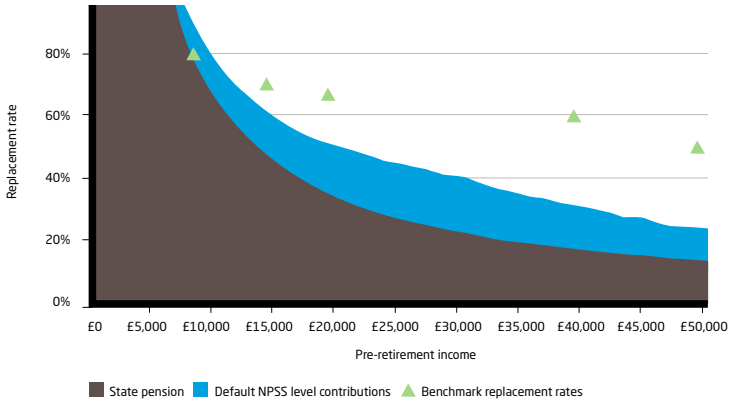
... but will they generate sufficient retirement income?

> "Recent analysis by the DWP suggests that around 12 million adults below state pension age are under-saving against the Pensions Commission's benchmarks"

No-one knows what level of income someone else will need in retirement. Indeed, most people don't know, before the event, what they themselves will need. Measures of sufficiency are, therefore, artificial but still necessary as a means of assessing the likely outcomes of a pension system.

It is now almost ten years since the Pensions Commission recommended the system of automatic enrolment that underpins the growth of workplace pensions. Their proposed design consciously set the outcomes from state pension and default contributions into what was then called the National Pension Savings Scheme (NPSS) below what they considered adequate replacement rates for anyone earning above about £10,000. The role of the state, as they saw it, was to strongly encourage people to get to a minimum income level through a combination of state pension and automatic enrolment and then enable people to make their own decisions about how to get to a higher replacement rate.

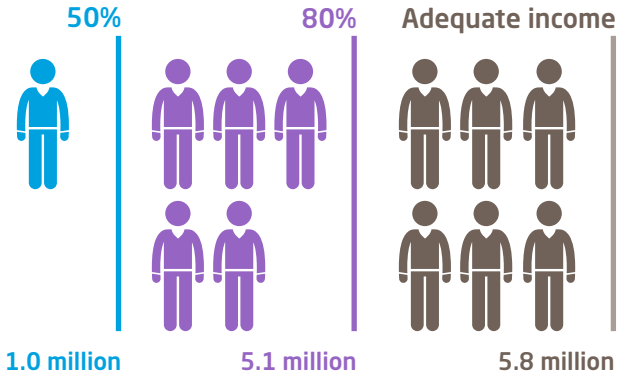
Pensions Commission: system outcomes versus benchmark replacement rates



In practice, the current system looks likely to deliver something close to the Pensions Commission's intention over the longer–term. The higher people's pre-retirement income, the more likely that the combination of state pension and statutory minimum contributions alone will leave people disappointed with their outcome in retirement. Recent analysis by the DWP[5] suggests that around 12 million adults below state pension age are under-saving against the Commission's benchmarks.

Of these, almost half are close to

their target and through saving a little more could achieve their target replacement rate.



Most undersavers are higher earners. Less than one in four of those earning £12-23,000 and less than one in ten of those earning less than £12,000 are undersaving on this measure.

At present, most savers receive much more than the minimum contribution levels. 65% of workplace pension scheme members receive an employer contribution in excess of 10% of earnings[6], largely because of the dominance of DB schemes in the public sector. Even in DC schemes, where contributions are typically lower than

[5] DWP, Scenario analysis of future pension incomes, 2014 [6] ASHE 2013

in DB schemes, 71% of members receive an employer contribution of 4% or more[7]. Overall, average contribution rates by employers and employees combined stood at 9% of earnings for DC schemes and 19% of earnings for DB schemes in 2011[8].

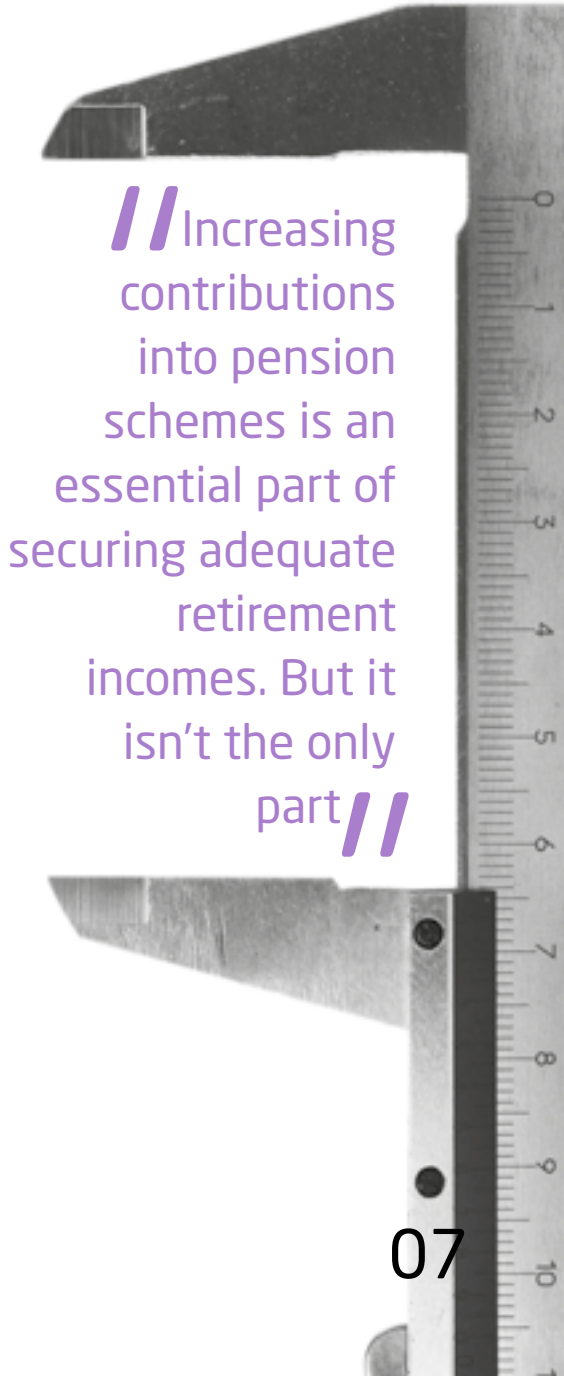
This pattern is changing quickly with the rollout of automatic enrolment though. Millions of people who weren't previously saving at all are now saving something. Typically they are receiving contributions at the statutory minimum level and, in the future, may benefit from increasing their contribution rate. Having done the right thing by accepting their automatic enrolment, significant numbers may be at risk of disappointment with their eventual outcome.

so should we seek to increase pension contributions?

Increasing contributions into pension schemes is an essential part of securing adequate retirement incomes, however we define 'adequate'. But it isn't the only part – working longer and other forms of saving will play a role for many - and for some savers, particularly lower earners, forcing or nudging more pension saving might just be the wrong thing to do. In a context where corporate, household and Government budgets remain tight we need to be very cautious about both the timing and impact of any measures designed to increase savings rates.

Levers to increase pension contributions

	Pros	Cons
Further compulsion on contribution rates – for example, increasing minimum contribution levels in stages after 2018 to reach 6% employer and 6% employee over time	Builds on the existing momentum of automatic enrolment	Could create higher levels of opt-out. Could reduce employer compliance levels as the cost of supporting automatic enrolment rises. Will add pressure to already strained household budgets, and could cause some people to save 'too much' in their pension.
Increasing individual incentives to save – for example, introducing a flat rate of tax relief at around 25% and presenting it as a matching contribution	Opportunity to make tax relief better understood Focuses incentive of tax relief better on those – moderate earners – who are most likely to respond to incentives by saving more	All higher rate tax payers lose relative to current situation. Higher rate tax payers who remain higher rate tax payers in retirement lose in absolute terms. Very complex to implement in DB schemes – requires calculation of notional contribution for each member each year.
Increase incentives on employers to contribute	Builds on the logic of automatic enrolment, uses employer contributions to leverage additional employee contributions	Requires funding and, if through reduction in tax relief available to individuals, will reduce individual incentives to save. Risk of dead weight as incentive is paid to employers who might choose to pay higher contributions in any case
Inform and educate	Maintains the current balance of state intervention. Broader benefits of growing financial capability and creating self-sustaining norms about saving for retirement.	The available evidence, from the UK and elsewhere, suggests that information and education have very limited success in increasing savings levels.



"Increasing contributions into pension schemes is an essential part of securing adequate retirement incomes. But it isn't the only part"

[7] ASHE 2013 [8] ONS, Pensions Trends 2013, table 8.1

The cons set out here are not absolutes and could to some extent be mitigated through careful design and planning. It would be possible, for example, to limit the impacts of higher compulsory contributions through phasing in increases gradually over the sort of timescales currently underway in Australia.

But fundamentally, there are no easy solutions and no need to rush to find them. It's easy to forget the rate at which progress which is already being made, through automatic enrolment, to get people saving something and the extent to which increasing contributions are already built into the automatic enrolment programme: individual savers will see their minimum contribution rate increase fivefold, from 0.8% of qualifying earnings to 4% of qualifying earnings between September 2017 and October 2018.

> "It's easy to forget the rate at which progress which is already being made, through automatic enrolment, to get people saving something"

We believe any proposals for increasing savings should:

- recognise that, despite Freedom and Choice, pension saving remains restricted compared with other forms of saving and should continue to be tax-advantaged for people at all income levels
- target incentives to save where they are proven to have greatest benefit
- avoid taxing people twice on the same tranche of income
- be understandable and stable so that individuals and employers can plan for the long term
- not impose excessive implementation costs.

so, where next?

We believe there is huge potential in the pensions system as it has developed in recent years. We also believe it is potential that needs careful monitoring and nurturing, with a clear focus on the long term. Subsequent sections of this document look at some of the ways that potential might be realised, calling for improvements to the governance and performance of pension schemes and a much greater understanding of the way in which people approach retirement and access their pension savings.

Underpinning all of that, though, is a fundamental point. For the emerging settlement to work it needs to be given a chance to work. It can be difficult to take the politics out of pensions; in many ways pensions – the redistribution of wealth between generations - are politics. But we must try, or risk undoing the potential of the current system through incremental improvements which turn out to have unintended consequences.

There are now several examples of Government providing a framework within which independent bodies – the Monetary Policy Committee, the Low Pay Commission, the Office for Budget Responsibility – make decisions and recommendations and provide a crucial check and balance on Government initiatives.

We believe that the establishment of an Independent Retirement Savings Commission is the best way to ensure that eyes remain focussed on the long term not the short term, on the overall retirement savings landscape not its component parts and, fundamentally, on the needs of savers. The Commission would define target outcomes, measure progress towards them, make recommendations for change and provide impact assessments of Government proposals for change. It would be accountable to Parliament with a statutory requirement to undertake a full annual review and report. It should be established in time to produce its first report to coincide with the already-planned 2017 review of automatic enrolment.

Recommendation 2:

the Government should establish an Independent Retirement Savings Commission with a remit to:

- define target outcomes for retirement savings;
- measure and report progress towards those outcomes;
- make recommendations for policy initiatives to improve performance;
- assess Government policy recommendations for impact on those outcomes.

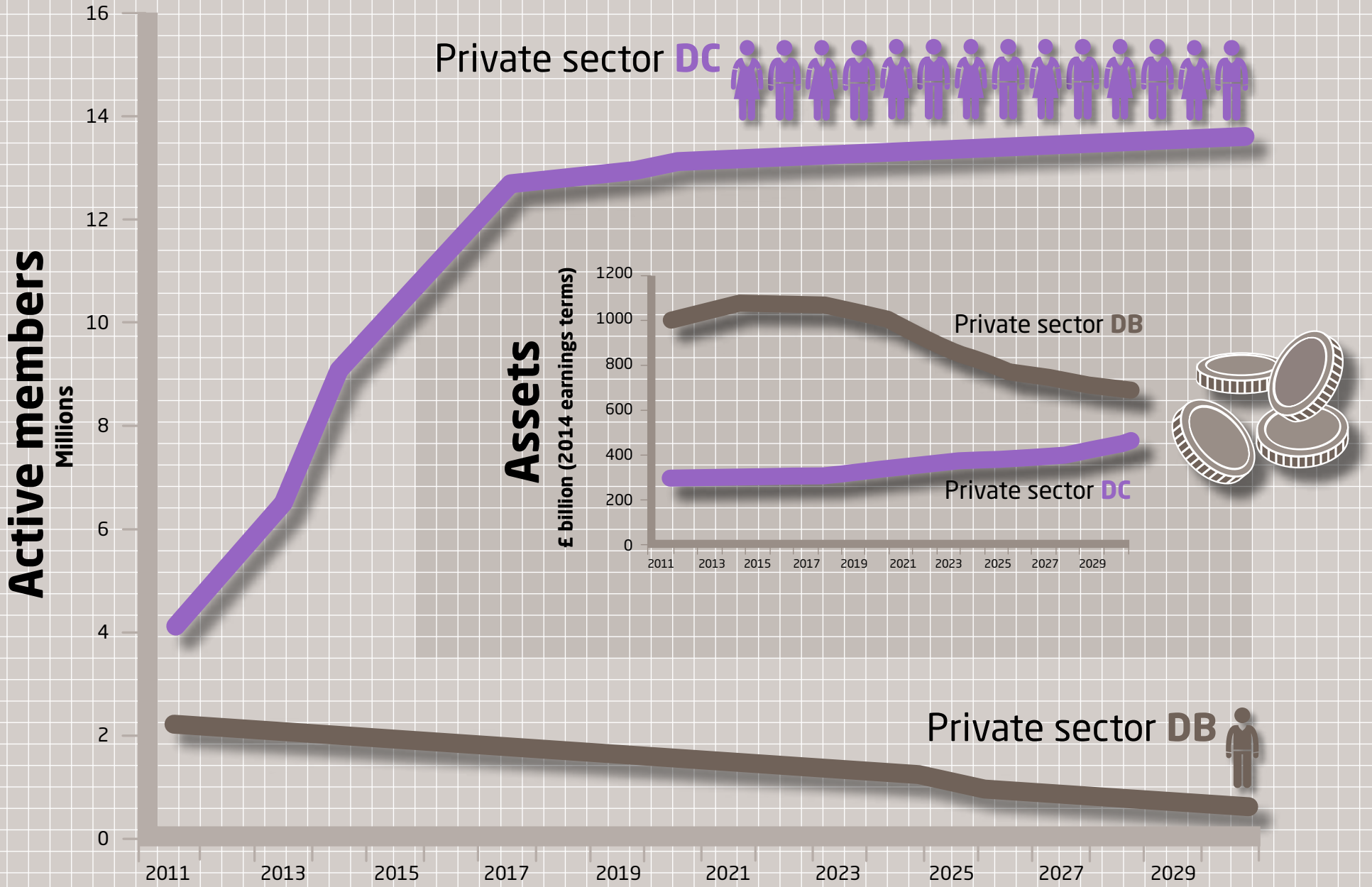
Section 2:

Adding value to members' savings

Enabling schemes to deliver for their members

The promise of DB and the potential uncertainty of DC will continue to dominate the pension landscape for many years to come. DB will continue to be the main source of pension income for years to come, while DC will come to be the main source of pension saving as DC schemes dominate automatic enrolment. While we support the development of new forms of risk-sharing in pensions we believe the market for shared risk schemes is unproven and we do not expect them to play a major role in the near future.

We believe our recommendation of an Independent Retirement Savings Commission has an important role to play in managing the environment in which all schemes operate. The Commission should, for example, manage a joined-up assessment of the cumulative costs of all the reforms and regulatory changes required of pension schemes to ensure that, in the round, the benefits of change outweigh the costs. This section looks at some of the additional measures which are required to ensure those running, in turn, DB and DC schemes can be empowered to deliver for their membership.



Source: Pensions Policy Institute, How will automatic enrolment affect pension saving?

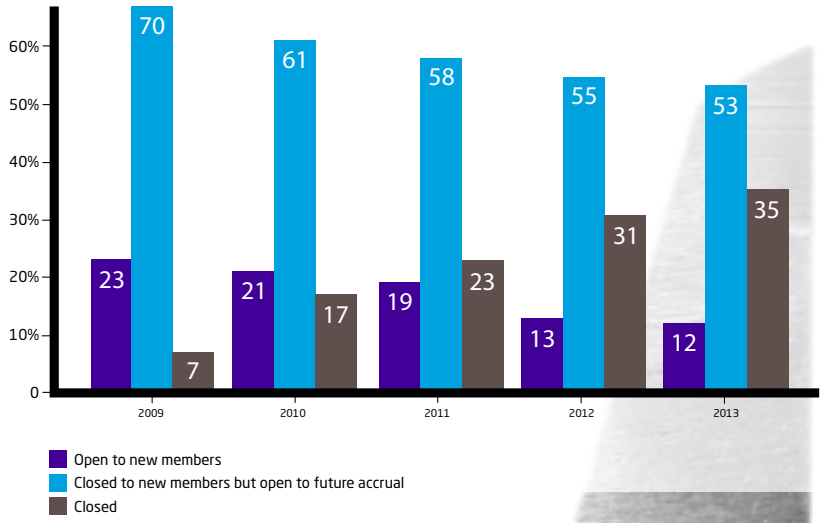
In addition there are over five million active members of public sector DB schemes. The Local Government Pension Scheme – the main funded scheme in the public sector – has 1.6 million of these members and holds £167 billion of assets.

Managing the gradual decline of defined benefit

Ensuring employers can meet their promises to employees

Defined benefit (DB) pension schemes have gone through a period of fairly rapid decline. In 2000, 88% of DB schemes were open to new members. This has now fallen to just 12%, with 30% of schemes now closed to future accrual[9]. This shift has been driven by a number of factors, including increases in longevity, an increasing regulatory burden and changes in the labour market, all of which have increased scheme liabilities. This has been exacerbated by the global financial crisis and the resulting UK monetary policy. The NAPF has estimated that the Bank of England's programme of Quantitative Easing (QE) increased UK DB pension scheme liabilities by £90bn[10].

Scheme status 2009-2013 (private sector only)



Source: NAPF Annual Survey

"DB pension provision will remain an important part of the pensions and investments landscape for years to come"

[9] PPF/TPR, The purple book, 2013. [10] NAPF, Exceptional times, exceptional measures?, 2012

But DB pension provision will remain an important part of the pensions and investments landscape for years to come. Just under one third of the workforce (both public and private sector) are still accruing benefits in a DB scheme[11]. These schemes have around £1 trillion of assets under management and will continue to pay pensions to their members and beneficiaries for decades to come.

Making sure that employers can keep their DB promises to past and present employees will therefore be a critical part of the pensions landscape well into the future and Government needs to ensure that the cost of meeting those promises remains affordable.

Managing the DB run-off

To ensure they can meet their promises to members, DB schemes need to invest in assets which have a similar profile to their liabilities. They need assets which return an inflation-linked stream of income decades into the future. As schemes mature, and, in particular, as they close to future accruals, an increasing proportion of their demand is for these liability-matching investments. Typically, schemes have looked to index-linked gilts to meet this demand.

In 2013, 40% of the NAPF fund members that responded to the Annual Survey stated their appetite for liability matching investments had increased in the previous 12 months. But there is a shortfall in the investment funds require to meet these needs. In order to fully hedge scheme liabilities[12], pension schemes would need access to an inflation-linked market of approximately £1 trillion. The total market value of current index-linked issuance was £404 billion at June 2014[13]. According to our projections[14], the supply of the index-linked gilt market available to pension schemes is expected to be lower than demand until around 2038. With half of all private sector schemes now using CPI to revalue deferred pensions[15], there is also a new and growing demand for gilts linked to CPI.

This persistent gap between supply and demand results in pension schemes bidding up the price of index-linked gilts. This makes pension promises more expensive for sponsoring employers than they otherwise would be and diverts corporate investment away from the real economy. A sustainable DB sector, which enables sponsors to both meet their promises and invest in growth, needs a significant increase in supply.

Recommendation 3a:

The Government should amend the strategic objectives of the Debt Management Office so that, in advising on managing Government debt, it can also to take into account the impact of insufficient supply of inflation-linked assets.

While index-linked gilts are seen by many as being the most attractive forms of liability matching assets, the NAPF recognises the limits on the gilt issuance any government can pursue. We also believe that other forms of inflation-linked assets are available, or can be made available – and that schemes will welcome these as assets to match their liabilities.

[11] ONS, ASHE 2013 [12] On a S179 basis, Purple Book 2013. [13] DMO, quarterly review 30 June 2014. [14] DB run-off, NAPF, June 2014. [15] NAPF Annual Survey 2013

> "Ensuring the effective running of DB pension schemes is about more than ensuring a supply of suitable assets"

Chief among these is infrastructure. The Government's National Infrastructure Plan has highlighted the need for over £375 billion in new investment within the next decade. More importantly, there is already vast range of operational infrastructure assets that would make attractive investments for pension funds – pension fund trustees need experience of this first before they will be willing to invest in new assets. Unlocking this investment opportunity would be a significant benefit for the economy, while the inflation-linked nature of the cash flows from these assets will help DB schemes to meet their liabilities.

While we recognise the improvement in infrastructure planning that has taken place over the last two years, it is important that the government makes infrastructure investment attractive and cost-efficient for long-term investors. The reforms aimed at attracting pension funds to PF2 need to be carried forward into other areas such as the VAT treatment of infrastructure investment vehicles, which require reform in order to enable – not penalise – new investment structures that open up infrastructure for pension funds. If institutional investors are to play a greater role in financing new infrastructure development, the government must develop a clear pipeline of suitable assets, with appropriate structures and investment characteristics, and make them available to long-term investors. The NAPF set out a number of specific recommendations in our Budget Submission 2014[16] to aid investment in infrastructure.

Recommendation 3b:

the Government should undertake a package of measures to unlock large-scale investment in national infrastructure, headed by a Minister with specific responsibility for infrastructure.

a pragmatic regulatory regime

Ensuring the effective running of DB pension schemes is about more than ensuring a supply of suitable assets. Both open and closed DB schemes require a pragmatic regulatory regime that ensures members' benefits are protected without placing undue burdens and requirements on schemes.

We're pleased that following NAPF campaigning, the Government has now introduced a new statutory objective for the Pensions Regulator to "minimise any adverse impact on the sustainable growth of an employer", bringing together consideration of long-term pension scheme funding plans with consideration of the long-term growth of the sponsoring employer.

But it's not just the UK regulatory landscape that needs to be proportionate. One of the biggest regulatory threats to DB pension provision in the UK are the Solvency proposals put forward by the European Commission. The NAPF and other key employer and employee organisations have continuously raised concerns that proposals to introduce a 'Holistic Balance Sheet':

- significantly increase funding requirements for DB schemes, leading to more scheme closures and sponsor bankruptcies; and
- undermine economic growth by diverting capital that would otherwise be used for investment and business expansion.

The European pension regulator's own report on the holistic balance sheet proposals showed that deficits in the UK would rise by 50% from £300bn to £450bn. We believe that such a regime will find it difficult to take account of the unique nature of the UK DB scheme funding regime and, ultimately, risks the future sustainability of UK pension schemes, thereby undermining the Commission's objective – shared by the NAPF – of delivering secure, adequate and sustainable pensions.

Recommendation 4:

the Government should oppose any further attempts by the European Commission to drive up funding requirements through the creation of a 'Holistic Balance Sheet'.

[16] NAPF Budget Submission 2014

Building sustainable pensions

DB provision also continues to play a major part in public sector employee benefit packages. This includes the Local Government Pension Scheme (LGPS) which, as one of the largest funded pension schemes in the world, remains a vibrant part of the occupational pensions landscape, providing pensions for **4.7m** people and managing nearly **£180bn** of assets.

The NAPF believes that all public service workers should have access to good quality, sustainable and affordable pensions. We believe that future reform of the LGPS should be based on a rigorous assessment of the performance of individual local authority funds and should seek to bring poorly-performing funds up to the standard of the many funds which are already performing strongly.

"The NAPF believes that all public service workers should have access to good quality, sustainable and affordable pensions"

The brave new world of defined contribution

> "Defined contribution schemes can deliver great results"

Building schemes that deliver what savers need

Defined contribution schemes can deliver great results. But they need careful management, delivered by people acting in the interests of savers, to do so. There are three key factors that will determine how effectively contributions into a DC scheme will be turned into a retirement income. All can be difficult for individual savers acting alone to assess and make decisions on.

1. The level of investment growth

- Where those running schemes need to make sure that investment strategies are appropriate for their membership, not just when they're introduced, but over the long term. This requires regular assessment of fund manager performance in delivering the strategy and regular reviews of the appropriateness of the overall strategy.

2. The amount of charges taken out of the pot

- Where those running schemes need to help members understand not just that the scheme is compliant with the new charge cap of 0.75% AMC but also that fund management charges outside of the charge cap are proportionate and that, in the round, savers are getting value for their money.

3. The way those savings are converted into a retirement income

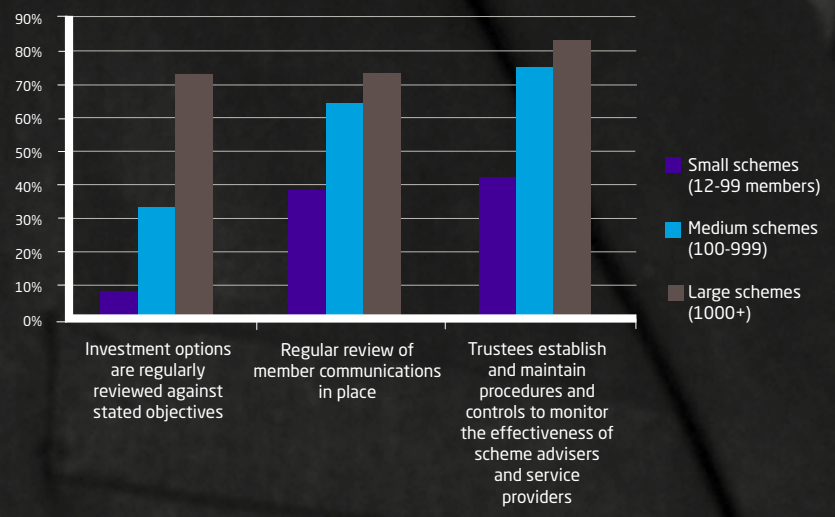
- Where those running schemes will have a crucial role in helping savers navigate the new freedoms introduced by Budget 2014. In particular, they will need to give their members comprehensible, timely information, complementing the Guidance Guarantee, to build understanding of the range of income options which are likely to develop.

In the past, it has been left to individual savers to try to steer the right course when it comes to these factors, by picking investment funds and shopping around for an annuity. However, the vast majority are unengaged in pensions and are ill-equipped to make informed decisions about whether a retirement product is good value or what the best investment strategy is.

Therefore, it is essential that trustees and providers use their knowledge and expertise to ensure all scheme members can benefit from good-value investment strategies and are able to understand their retirement options. In many DC schemes this already works well, with investment strategies developed with a strong understanding of members' needs, and support provided to scheme members to help with retirement decisions.

However, for many years the NAPF has been raising concerns about the mixed quality of the 40,000 DC schemes in the UK – more than 35,000 of which have fewer than twelve members[17] - and the potential risk this poses to savers of not getting the most from their contributions. The NAPF believes that all workers should be able to save into a scheme that is well-run and good value, with robust governance arrangements. The Pension Regulator's review of governance arrangements shows huge variability in standards with larger schemes typically performing much better than smaller schemes.

Variability in the quality of DC governance



Source: The Pensions Regulator, DC trust-based pension schemes features research, May 2014

what types of schemes can deliver for savers?

Pension schemes need strong governance to be able to deliver better outcomes for members. Key to this is the interests of those controlling the scheme need to be aligned with those of the scheme members. In some pension arrangements there is too often a vested interest in using certain investment or retirement products, or administration and advice services. If set up correctly and resourced properly, independent governance can ensure scheme members have the best chance at getting good investment and retirement outcomes. Trustees have a clear 'fiduciary duty' to their members – a legal obligation to operate the scheme in the members' interest - and Government reforms of master trusts should ensure that commercial providers cannot unduly influence the trustees. The Independent Governance Committees (IGCs) which are being set up to help oversee contract-based schemes are clearly a move in the right direction. However, the key test will be whether they have adequate powers to stand up to the vested interests of the providers who run the schemes and whether they are truly independent.

[17] The Pensions Regulator, DC trust: a presentation of scheme return data 2013 - 2014

Good governance – setting the standard for pension schemes

Better boards are more likely to take better decisions. That means better long-term returns and greater responsiveness to beneficiary needs and interests; outcomes which the NAPF, and the industry as a whole, would welcome.

Extensive recent work on corporate governance has identified a number of significant key features of effective boards which could translate directly into effective trustee boards:

- Individuals around the board table who have sufficient time to devote to the role and so be appropriately informed but who are also sufficiently robust and independent to provide views and take decisions appropriately based on thought-through and debated perspectives.
- Boardroom behaviour where debate is welcomed and fostered so that a range of views is actively considered around the board table, and issues are discussed openly and accountably.
- Chairing which draws different views out from relevant individuals so that concerns are brought to the surface and questions are raised and debated, allowing sufficient time for proper debate.
- A diversity of views and backgrounds around the board table such that a range of perspectives can be reflected and considered in discussions.
- Active committees to which roles are properly delegated and which are fully accountable for their contributions, keeping the broader board informed as required, and bringing key decisions for active consideration by the full board.
- A robust succession planning process so that the board is renewed and receives regular new sources of challenge and debate while maintaining a degree of corporate memory.
- An open evaluation process so that the board challenges itself to improve and enhance its membership and approach over time.

"Bigger DC schemes are more likely to be able to access investment funds, advice and other services in a cost-effective manner"

However, while some smaller DC schemes are delivering good outcomes, often because of the backing of a supportive employer, many others struggle to be able to resource good governance due to their lack of scale. Bigger DC schemes are more likely to be able to access investment funds, advice and other services in a cost-effective manner.

The good news is that the DC market is already moving in the right direction. Automatic enrolment is creating larger schemes, with master trusts like NEST, NOW: Pensions and People's Pension growing rapidly. The Pension Regulator's latest analysis of schemes used for automatic enrolment shows a large surge in use of trust-based DC schemes, and particularly master trusts. Recent research from the Pensions Policy Institute[18] projects an increasing role for multi-employer schemes over the next two decades.

great governance and less prescriptive regulation

Because there are so many schemes, and standards of governance are so variable, the regulatory strategy for DC has become too prescriptive by attempting to regulate at a micro-level the work of trustees and scheme managers. For instance, the Regulator's DC Code is 58 pages long and includes 115 uses of the phrase "Trustees should" and 34 "Trustees must". This kind of regulation can lead to a tick-box culture and drives up costs, as schemes that are already well-run are forced to produce lengthy reports to demonstrate compliance.

Rather than prescribing precisely what trustees should be doing and how they should do it, regulation should focus on making sure the right governance framework is in place: that those in charge of the independent governance of schemes are free from conflicts and have the understanding, powers and resources needed to do their job of running the scheme.

A system of authorising and supervising schemes would allow the Pensions Regulator to set higher minimum standards of governance, focusing on key issues such as:

- the fitness, competence and expertise of the trustee board;
- trustees' powers and independence; and
- whether the scheme has the capacity and resources to support good governance.

Schemes which meet these minimum standards should have much greater freedom to assess and meet their members' needs and should be passported out of regulations and guidance designed for the generality of schemes. A scheme which is run by fit and proper people in the interests of its membership should not need, for example, to comply with disclosure requirements which specify the channel, content and frequency of member communications. Such a scheme will know its membership better than any Government or regulator can and will be better placed to produce a communication strategy and plan which strikes the right balance between engaging its membership and protecting it from unnecessary cost.

Recommendation 5:

The Government should change the regulatory framework for trust-based schemes, and develop a system for authorising and supervising schemes that sets high minimum standards of governance and relies much less on detailed regulations and codes. Working with the FCA it should ensure that similar standards apply to the independent governance committees being set up to oversee contract-based schemes.

This change in regulatory framework will enable schemes which meet the initial requirements to focus on the specific requirements of their membership, removing unnecessary costs and enabling those schemes to help members get more out of every pound of saving. It will also enable the regulator to focus on improving standards in less well-governed schemes. Over time, we expect the impact will be to accelerate the trends which are already apparent in the market: the growth of a relatively small number of large, well-governed schemes. Both regulators and the Independent Retirement Savings Commission will need to monitor this trend and be ready to take further action where poor governance persists.

> "Schemes which meet these minimum standards should have much greater freedom to assess and meet their members' needs"

[18] Pensions Policy Institute, How will automatic enrolment affect pension saving?, 2014

Making the most of what you've saved

The new and frightening world of retirement

In recent years, retirement has evolved:

- from a short period of non-work, typically in poor health, that followed a long period of work with few financial decisions to be made at retirement...
- to a longer period of retirement in better health following a shorter period in work, with many complex decisions to be made both at and following retirement.

The 2014 Budget may cause a significant further evolution in the nature of retirement, introducing new choices - and, therefore, new responsibilities - for retirees.

Pension schemes are grappling with these changes and trying to help many of the 11.5 million people aged between 50 and state pension age make sense of their retirement options. To help that process the NAPF is embarking on a major programme of research to understand public attitudes to and experiences of retirement. As our initial research strongly suggests, people are approaching retirement with a mix of hope and fear, with limited understanding of their options and with insufficient preparation to make the most of their finances in retirement.

hopes for retirement dented by fears about the transition

In recent years, several research projects have highlighted common themes about what retirement will be like; namely a period of:

- less stress, more 'me time' and more freedom;
- helping out family, travelling and a wide range of leisure activities;
- for some, unpaid or flexible paid work to boost incomes and maintain independence; and
- transition from good health and high levels of activity and spending to a (hopefully short) period of poorer health with lower levels of activity and spending.

Our own retirement research[19] confirms that those retiring today retain hope that, once retired, life will mirror these expectations. However the research also highlights a number of growing concerns and uncertainties about the transition into retirement which are being driven by the rapid pace of change in pensions, both state and private, changes to working patterns and in the delivery and funding of social care in later life. The prospect of a pleasant retirement is being obscured for many by the fear and confusion about the decisions that they personally have to make along the way, with little or no help from informed sources that they feel that they can trust. The diagram below summarises the sense of uncertainty, lack of capability and limited support that many research respondents described.

> "The 2014 Budget may cause a significant further evolution to the nature of retirement"

[19] NAPF 'Understanding Retirement' research programme. Phase I research, July 2014 (unpublished qualitative research among those with a private pension and within 5 years either side of years of retirement)

changes to state pension age unsettling

For many, the trigger point and framing for retirement remain either the state pension age or the normal pension age associated with an individual's main or only private pension. With both of these dates changing (in the minds of the public, more than they actually are), those approaching retirement appear to be unsettled about exactly when and how they will retire.

The date on which those with DC pensions think they might retire is less certain than for those with DB pensions, either because they don't feel financially secure and/or because they are less certain or confident about how to turn their pension fund into an income.

As uncertainty increases, solutions need to be found to help those approaching retirement understand the point at which they can afford to retire. For those with long-term DB pensions and for those reliant on state pensions, the decision will remain relatively simple. However, for those with DC pensions, particularly those with multiple pension pots, there will be much less clarity.

Efforts to improve public understanding of the shifting state pension age and its relevance to them as individuals need to be stepped up.

the future is full of guesswork and assumption

While the role of private retirement provision is recognised as being more and more important, many of today's retirees' funds have been depressed by recent stock market performance and low interest rates. Not only are many people gloomy about their income prospects, many have little or no idea of how much they can expect their income to be as they approach retirement, making retirement planning even more complex and uncertain.

"I thought that I would probably be happy to retire at state pension age: I think it was 55 at that time. Had I known I would have to work until I was 67 I would have had a different perspective. 10 years makes a huge difference. I assumed I would get a government pension and that it would be enough..."

Female respondent

"I think private pensions give you more choice and a bit more flexibility, a bit more control on … your retirement. Choice as in you've got an option how much you want to put in when you're working … and that gives you the choice on when you choose to retire"

Male respondent

IFS analysis in 2012[20] revealed that one third of those approaching retirement were unable to anticipate what their future retirement income might be, 46% could provide a range and 22% could give a precise figure. Those nearer retirement were more likely to be able to give a precise figure. However, those who were able to report an expected income in retirement appeared to provide optimistic estimates of their retirement income. The IFS calculated that typically they would need to increase their fund value by 77% to achieve the income that they expect to receive.

"The original illustrations they provided of 8% and 10% a year have not been realistic. Some have just grown by 3% or less and some have even shrunk…"

Female respondent

It is clear that changes are required to the way in which retirement income prospects are communicated. Research by NEST[21] in 2014 identified and tested a number of different ways of communicating the uncertain outcomes of a DC pension in ways that members could understand. The research showed that, for example, projections which illustrate a range of possible outcomes help people understand their options better than the type of specific projection which is currently required by law.

Finding new and effective ways to communicate the consequences of being in a DC pension in a world of 'Freedom and Choice' is essential in helping people make informed retirement decisions. Will we all have to work longer?

The ability to carry on working is for some the defining factor in retirement decisions. NAPF research revealed mixed views on the role of work in later life. Three main groups were evident:

- those for whom retirement equates to stopping working altogether, either through choice or necessity;
- those for whom working into later life is an economic necessity; and
- those who want to work beyond 'retirement' to 'keep their brain ticking over' and for social engagement.

Working beyond normal or state pension age is seen as a very different experience than earlier working life, defined by its limited call on time and by its flexibility to fit in with extended holidays, caring responsibilities and reduced levels of stress.

[20] IFS, Expectations and experience of retirement in Defined Contribution pensions: a study of older people in England, jointly funded by NAPF and ESRC, 2012
[21] NEST, Improving consumer confidence in saving for retirement, 2014

"My ideal mix will be working 1-2 days a week somewhere. Maybe doing something voluntary. Maybe something like B&Q. I don't want to do too much. Maybe I'll drive a van. I want to do something where I don't have too much responsibility"

Female respondent

access to pre-retirement advice and information

Financial decisions made at or near retirement can be influenced by access to information and financial advice. From April 2015, they will also be influenced by the Guidance Guarantee promised by the Government in the 2014 Budget.

NAPF research has once again highlighted the gaps in the supply of good-quality support and information for those approaching retirement with few sources of help satisfying the need for independent, accessible and expert. Friends and family are the most accessible sources of help and information but are acknowledged as not being experts. On-line resources are trusted but may not be independent and not always expert in pensions. Employers are providing very mixed levels of support, often related to the size of the company and very hit and miss for those approaching the end of their working lives. Pension providers and IFAs are experts but not always accessible and certainly not always seen to be independent. Awareness of guidance services such as the Money Advice Service, the Pensions Advisory Service, Citizens' Advice and Age UK providing help in these areas remains very limited.

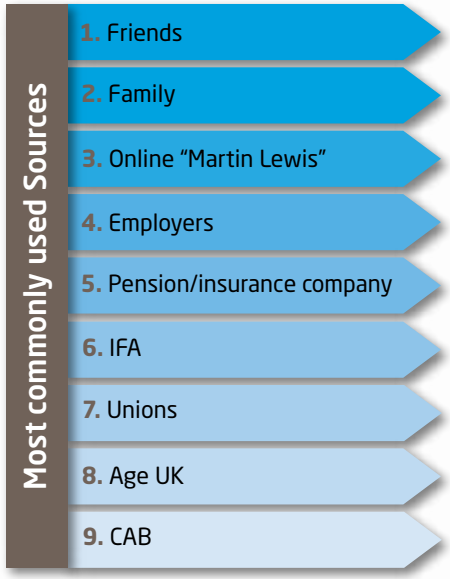
Building confidence in the accessibility, expertise and independence of any future guidance service will be central to ensuring engagement with the service.

supporting retirement decisions

While many have talked about the death of retirement as we've come to know it, today's retirees still dream of, and expect, an extended period of comfortable retirement. However, the idea of retirement engenders mixed feelings of apprehension and anticipation.

For those faced with the prospect of converting their pension funds into an income in retirement, the prospect of making that decision and controlling their funds in retirement is seen in both a positive and negative light:

A broad range of sources - but none considered especially effective



- On the one hand, many are delighted with the prospect that they do not have to buy an annuity.
- On the other, many fear that they do not have the capability to make the right decision, fear running out of money and worry about inflation and long term care needs.
- Some explicitly and some implicitly hanker after a world of greater simplicity where decisions are made for them.

"NAPF research has once again highlighted the gaps in the supply of good quality support and information for those approaching retirement"

Addressing the difficulties faced by those approaching retirement with DC pensions requires a response from policymakers, regulators and other stakeholders in the pensions sector. Our research highlights four key areas of concern:

- **Pension design and choice architecture** – it will be critical that new retirement income options are made available that both incorporate freedom and choice but also reduce the risks to the individual of running out of money and being exposed to high charges. There is a very real risk that an abundance of product choices will simply add to the uncertainty and confusion and could lead to poor outcomes. Pension scheme members will look for help in narrowing down their range of options. In the first instance, many will look to their pension scheme for help. Whether through schemes developing their own income vehicles or default pathways into selected products, many pension scheme members will require help in guiding them into the best product for them, both at retirement and in much later life.

Recommendation 6a:

The Independent Retirement Savings Commission should be given responsibility for reviewing the advice, products and solutions available to those retiring, the take-up of different products and solutions and the outcomes for those choosing them with a view to advising the Government and FCA on the regulation of products and advice and ways in which risks to individuals can be reduced.

- **Clarity about possible outcomes** – the way in which pension schemes communicate with their members about their retirement choices needs to keep up with saver preferences. People need to be engaged in understanding the range of possible outcomes that could arise from their decisions as they approach and move into retirement.
- **Support for those who wish or need to work longer** – the Government's framework for 'Fuller Working Lives' is an essential part of the future landscape for retirement. Flexibility in later life working , whether part-time or a gap year, is critical to ensure good retirement outcomes.
- **Information and guidance**– the Government's plans for guidance at retirement need to be delivered through independent, expert and accessible providers of the service. However, there will continue to be an important role for employers, pension schemes and other advisers. Information and guidance about retirement also need to be thought of as a programme which ends with guidance at retirement rather than one which starts with it. We believe the current review of the Money Advice Service offers an important opportunity to refocus Government funding towards this critical activity.

Recommendation 6b:

The Government should use the review of the Money Advice Service and the establishment of the Guidance Guarantee to increase the amount spent on information and education on retirement and should explore ways of using the third party funding model used to deliver debt advice to improve the reach of information and education services.

> "There is a very real risk that an abundance of product choices will simply add to the uncertainty and confusion and could lead to poor outcomes"

Launching the NAPF 'Understanding Retirement' research series

The NAPF is launching a major research series examining the nature of retirement for those recently retired and those coming up to retirement in the next 15-20 years; essentially the generation of baby boomers born between 1946 and 1965.

The purpose of the series is to inform both public policy and the design of private sector pension and retirement income products as well as helping to shape the guidance and help that is needed as retirement approaches, at the point of retirement and beyond.

The research programme has been initiated by phase I research exploring the reality of retirement today and summarised above:

- To what extent are the expected changes in retirement evident today?
- What is driving retirement decisions?
- How is retirement being experienced – the good, the bad, the indifferent?
- How is pension provision (and other investments and savings) shaping retirement expectations and experiences?
- What are those hoping to retire in the near future expecting from retirement and their pensions?

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